

General Information Letter: There is no limitation on the deduction for capital losses incurred that is allowable in computing the replacement tax liability of a Subchapter S corporation.

April 7, 2000

Dear:

This is in response to your letter dated February 14, 2000 in which you request a Letter Ruling. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department (see 2 Ill. Adm. Code 1200.120(b) and (c), available on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>).

Although you have not specifically requested either type of ruling, the nature of your question and the information provided require that we respond only with a GIL.

In your letter you stated:

We would appreciate a letter from you concerning the deductibility of a capital loss incurred at the corporate level by an S-Corporation in the calculation of Illinois replacement taxes.

Our feeling is that such losses are deductible for replacement tax calculation and capital gains are includeable for replacement tax calculation, in spite of their federal income tax treatment (passing through to shareholders' personal returns).

DISCUSSION

In answer to your question, as Mr. Caselton mentioned in your phone conversation for S corporations capital losses are deductible for replacement tax calculation and gains are includeable. Taxable income is defined for S corporation purposes at §203(e)(2)(G) of the Illinois Income Tax Act, which states:

In the case of: (i) a Subchapter S corporation for which there is in effect an election for the taxable year under Section 1362 of the Internal Revenue Code, the taxable income of such corporation determined in accordance with Section 1363(b) of the Internal Revenue Code, except that taxable income shall take into account those items which are required by Section 1363(b)(1) of the Internal Revenue Code to be separately stated; and (ii) a Subchapter S corporation for which there is in effect a federal election to opt out of the provisions of the Subchapter S Revision Act of 1982 and have applied instead the prior federal Subchapter S rules as in effect on July 1, 1982, the taxable income of such corporation determined in accordance with the federal Subchapter S rules as in effect on July 1, 1982;

Section 1363(b) of the Internal Revenue Code explains the method used by a corporation to compute its income. Subsection (b)(1) then directs the taxpayer to §1366(a)(1)(A) of the Internal Revenue Code which states that "items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder..." shall be taken into account in computing income. Since capital gains and losses could obviously affect the liability for tax of a shareholder they would qualify as separately stated items under §1363(b)(1) of the Internal Revenue Code and would thus be taken into account in determining S corporation taxable income for replacement tax purposes under §203(e)(2)(G) of the Illinois Income Tax Act.

In addition, §1363(b)(2) directs that the deductions referred to in §703(a)(2) shall not be allowed to the corporation. By inference, §703(a)(1) is allowed. Section 703(a)(1) states that the items described in §702(a) shall be separately stated." Section 702(a) provides the general rule for determining income for partners and subsection (a)(1) and (2) allow gains and losses from the sale of short and long term capital assets, respectively. As this process flows from §203(e)(2)(G) of the Illinois Income Tax Act's reference to Internal Revenue Code §1363(b)(1), the S corporation would be allowed to use the gains and losses from capital assets when computing taxable income for the replacement tax.

As mentioned above, this is merely a general information letter and not a statement of policy and is not binding upon the Department. I hope that this has been helpful to you. The Department maintains a website, which can be accessed at www.revenue.state.il.us. If you have additional questions please feel free to contact me at the above address.

Very Truly Yours,

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